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by Hale E. Sheppard

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In this article, Sheppard explains why the IRS's settlement initiative on conservation easements might be unappealing to many taxpayers.

I. Introduction

The IRS is attacking partnerships that donate conservation easements to charitable organizations and then pass along the corresponding tax deductions to their partners. In an effort to dispense with cases quickly and avoid addressing the key issue — valuation of easements — the IRS often raises a long list of technical arguments. These generally focus on unintentional flaws with the deed of conservation easement, the appraisal, or Form 8283, "Noncash Charitable Contributions." To the dismay of many in the conservation, tax, and legal communities, the Tax Court has ruled in favor of the IRS on technical issues in several recent cases.[1]

The IRS, leveraging the momentum from its recent victories, issued a release in late June describing a potential path to resolution (the settlement initiative).[2] The Tax Court has a backlog of conservation easement cases, with many more to come; the IRS has limited resources; and the IRS knows that many of the technical issues it is currently exploiting are absent in transactions after 2015. Therefore, announcing the settlement initiative makes sense from the IRS's perspective. As this article explains, however, the settlement initiative contains severe terms and creates uncertainty, which might make it unappetizing to many taxpayers.

II. Conservation Easement Donations

Some background on conservation easement donations is important in understanding the problems with the recent settlement initiative. The following is an overview.

Taxpayers that own undeveloped real property have several choices. For instance, they might (1) hold the property for investment purposes, selling it when it appreciates sufficiently; (2) determine how to maximize profitability from the property and do that, regardless of the negative effects on the local environment, community, and economy; or (3) donate an easement on the property to a charitable organization, so it is protected forever for the benefit of society. The third option not only achieves the goal of environmental protection, but also triggers another benefit: tax deductions for donors.

As one would expect, taxpayers cannot donate an easement on any old property and claim a tax deduction; they must demonstrate that the property is worth protecting. A donation has an acceptable conservation purpose if it meets at least

[1] *See, e.g.*, *Lumpkin One Five Six LLC v. Commissioner*, T.C. Memo. 2020-94; *Lumpkin HC LLC v. Commissioner*, T.C. Memo. 2020-95; *Plateau Holdings LLC v. Commissioner*, T.C. Memo. 2020-93; *Village at Effingham LLC v. Commissioner*, T.C. Memo. 2020-102; *Riverside Place LLC v. Commissioner*, T.C. Memo. 2020-103; *Maple Landing LLC v. Commissioner*, T.C. Memo. 2020-104; *Englewood Place LLC v. Commissioner*, T.C. Memo. 2020-105; *Smith Lake v. Commissioner*, T.C. Memo. 2020-107; *Belair Woods LLC v. Commissioner*, T.C. Memo. 2020-112; *Cottonwood Place LLC v. Commissioner*, T.C. Memo. 2020-115; and *Red Oak Estates LLC v. Commissioner*, T.C. Memo. 2020-116.

[2] IR-2020-130.

one of the following requirements: (1) it preserves land for outdoor recreation by, or the education of, the general public; (2) it preserves a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem; (3) it preserves open space (including farmland and forestland) for the scenic enjoyment of the general public and will yield a significant public benefit; (4) it preserves open space (including farmland and forestland) in accordance with a federal, state, or local governmental conservation policy and will yield a significant public benefit; or (5) it preserves a historically important land area or a certified historic structure.[3]

Taxpayers memorialize the donation to charity by filing a public deed. In preparing the deed, taxpayers often coordinate with the land trust to identify specific limited activities that can continue on the property after the donation without interfering with the deed, prejudicing the conservation purposes, or jeopardizing the tax deduction.[4] These activities are called reserved rights. The IRS, in its Conservation Easement Audit Techniques Guide (ATG) and elsewhere, openly recognizes that reserved rights are ubiquitous in deeds.[5]

The IRS will not allow the tax deduction stemming from a conservation easement unless the taxpayer, before making the donation, provides the land trust with "documentation sufficient to establish the condition of the property at the time of the gift."[6] This is called the baseline report. It may feature several things, including (1) survey maps from the U.S. Geological Survey showing the property line and other contiguous or nearby protected areas; (2) a map of the area drawn to scale showing all existing man-made improvements or incursions, vegetation, flora and fauna (for example, locations of rare species, animal breeding, roosting areas, and migration routes), land use history, and distinct natural features; (3) an aerial photograph of the property at an appropriate scale taken as close as possible to the date of the donation; and (4) on-site photographs taken at various locations on the property.[7]

The value of the conservation easement is the fair market value of the property at the time of the donation.[8] FMV ordinarily means the price on which a willing buyer and willing seller would agree, with neither party being obligated to participate in the transaction, and with both parties having reasonable knowledge of the relevant facts.[9] The IRS explains in its ATG that the best evidence of the FMV of an easement would be the sale price of other easements that are comparable in size, location, usage, etc. The ATG recognizes, though, that it may be difficult, if not impossible, to find comparable sales.[10] Consequently, appraisers often must use the before-and-after method instead. This means that an appraiser must determine the highest and best use (HBU) of the property *and* the corresponding FMV twice. First, the appraiser calculates the FMV as if the property were put to its HBU, which generates the "before" value. Second, the appraiser identifies the FMV taking into account the restrictions on the property imposed by the easement, which creates the "after" value.[11] The difference between the "before" value and the "after" value, with some other adjustments, produces the value of the easement donation.

As indicated earlier, in calculating the FMV of property, appraisers and courts must take into account not only the current use of the property, but also its HBU.[12] A property's HBU is the most profitable use for which it would be adaptable and needed in the reasonably near future.[13] HBU has also been defined as the use of property that is physically possible, legally permissible, financially feasible, and maximally productive.[14] Importantly, valuation in the easement context does not depend on whether the owner has

[3] Section 170(h)(4)(A); reg. section 170A-14(d)(1); and S. Rep. No. 96-1007, at 10 (1980).

[4] Reg. section 1.170A-14(b)(2).

[5] IRS, "Conservation Easement Audit Techniques Guide," at 23 (rev. Jan. 24, 2018) (ATG); *see also* reg. section 1.170A-14(e)(2) and (3).

[6] Reg. section 1.170A-14(g)(5)(i).

[7] Reg. section 1.170A-14(g)(5)(i).

[8] Section 170(a)(1) and reg. section 1.170A-1(c)(1).

[9] Reg. section 1.170A-1(c)(2).

[10] ATG, *supra* note 5, at 43.

[11] *Id.*

[12] *The Stanley Works v. Commissioner*, 87 T.C. 389, 400 (1986); reg. section 1.170A-14(h)(3).

[13] *Olson v. United States*, 292 U.S. 246, 255 (1934).

[14] *Esgar Corp. v. Commissioner*, 744 F.3d 648, 659 n.10 (10th Cir. 2014).

actually put the property to its HBU in the past;[15] the HBU can be *any* realistic potential use of the property.[16] Common HBUs are construction of a residential community, creation of a mixed-use development, or mining.

Properly claiming the tax deduction stemming from an easement donation is surprisingly complicated. It involves a significant amount of actions and documents. The main ones are as follows: The taxpayer must (1) obtain a qualified appraisal from a qualified appraiser, (2) demonstrate that the land trust is a qualified organization, (3) obtain a baseline report adequately describing the condition of the property at the time of the donation and the reasons why it is worthy of protection, (4) receive from the land trust a contemporaneous written acknowledgement, both for the easement itself and for any endowment/stewardship fee donated to finance the perpetual protection of the property, (5) complete a Form 8283 and have it executed by all relevant parties, (6) (assuming that the taxpayer is a partnership) file a timely Form 1065 enclosing Form 8283 and the qualified appraisal, and (7) send all the partners their Schedules K-1 and a copy of Form 8283.[17]

III. Technical Challenges by the IRS

The ATG concerning conservation easements, which revenue agents and other IRS personnel follow when conducting audits, contains a "Conservation Easement Issue Identification Worksheet."[18] This worksheet identifies a large number of technical challenges that the IRS can (and does) raise in cases, including the following:

- the donation of the easement lacked charitable intent because there was some form of quid pro quo between the partnership and the land trust;
- the donation of the easement was conditioned on the partnership's receipt of the full tax deduction claimed on its Form 1065;
- the land trust failed to provide a contemporaneous written acknowledgement letter;
- the appraisal was not attached to the Form 1065 filed by the partnership;
- the appraisal was not prepared in accordance with the Uniform Standards of Professional Appraisal Practice, and thus is not a qualified appraisal;
- the appraisal fee was based on a percentage of the easement value;
- the appraisal was not timely, in that it was not sufficiently proximate to the making of the donation or the filing of the Form 1065 by the partnership;
- the appraiser was not a qualified appraiser;
- the Form 8283 was missing, incomplete, or inaccurate;
- the partnership's basis in the donated property, as listed on Form 8283, was improperly calculated;
- the manner in which the partnership obtained the relevant property was incorrectly described as a "purchase" instead of as a "contribution" by one of the partners;
- not all appraisers who contributed to the valuation process signed Form 8283;
- the baseline report insufficiently described the condition of the property;
- the conservation easement was not protected in perpetuity;
- mortgages or other encumbrances on the property were not satisfied or subordinated to the easement before the donation;
- the deed contains an improper clause regarding how the proceeds from sale of the property upon extinguishment of the easement would be allocated among the partnership and the land trust;
- the deed contains an amendment clause that theoretically might allow the parties to modify the donation, after taking the tax deduction, in a manner that undermines the conservation purposes;
- the deed contains a merger clause, as a result of which the fee simple title and the easement might end up in the hands of the

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[15] *Id.* at 657.

[16] *Symington v. Commissioner*, 87 T.C. 892, 896 (1986).

[17] *See* ATG, *supra* note 5, at 24-31; IRS Publication 1771, "Charitable Contributions — Substantiation and Disclosure Requirements"; IRS Publication 526, "Charitable Contributions"; section 170(f)(8) and (11); reg. section 1.170A-13; Notice 2006-96, 2006-2 C.B. 902; and T.D. 9836.

[18] ATG, *supra* note 5, at 83-86 (Exhibit 12-1).

same party, thereby impeding the ability to protect the property forever;
- the deed was not timely filed with the proper court or other institution;
- the land trust was not a qualified organization or an eligible donee;
- the deed allows for some degree of commercial forestry, which is supposedly incompatible with the notion of conservation; and
- the property lacks acceptable conservation purposes for any number of reasons, including that the habitat is not protected in a relatively natural state, there are insufficient threatened or endangered species on the property, the habitat or ecosystem to be protected is not "significant," the public does not enjoy physical or visual access to the property, the property lacks historical significance, the conservation purposes do not comport with a clearly delineated government policy, or the easement allows uses that are inconsistent with the conservation purposes.[19]

The ATG seems to encourage creativity, explaining to IRS personnel that the checklist should *not* serve as a limitation. Indeed, it states: "This worksheet is not an all-inclusive list of potential issues for donations of conservation easements. Users should review IRC Section 170, [Deficit Reduction Act of 1984] Section 155, the corresponding Treasury Regulations, Notice 2006-96 and case law."

IV. The IRS's Settlement Terms

As indicated earlier, the IRS has experienced some success in the Tax Court recently, taking advantage of unintentional defects in deeds, appraisals, Forms 8283, and other documents related to easement donations. This triggered the settlement initiative.

A. Generally

The IRS explained in its release that the settlement initiative would apply only to cases that are currently docketed with the Tax Court — that is, cases for which petitions have already been filed with the Tax Court. Stated another way, the settlement initiative does not apply to cases that are under audit or are seeking review by the Appeals Office directly after an IRS audit. The IRS further explained in the release that an offer letter would "be sent by mail to those eligible." Partnerships began receiving those offer letters from the IRS in July, and the proposed settlement terms were the same in each.

B. Specific Questions

In an attempt to clarify otherwise murky matters, this article summarizes, in question-and-answer format, the information derived from the release (which is public) and the IRS offer letters (which are not).

1. To what type of transactions does the settlement initiative apply?

The offer letters indicate that the settlement initiative applies to syndicated conservation easement transactions (SCETs) and substantially similar transactions (SSTs), including some fee simple donations of property.

2. What is the deadline for making a decision?

The partnership and its partners must elect to participate in the settlement initiative within 60 days of the date on the offer letters.

3. How do the partnership and its partners make the election?

The partnership and its partners must elect to participate in the settlement initiative through the tax matters partner, who must initial each page of the offer letter, execute it, and return it to the IRS attorneys.

4. Must the IRS accept an election?

No, the election appears to be more of an acknowledgement of interest, or an application. The offer letters expressly state that they are not binding on the IRS, the partnership, or the partners; that they do not constitute acceptance by the IRS of an offer to settle; and that they do not ultimately obligate anyone to execute a Form 906, "Closing Agreement on Final Determination Covering Specific Matters."

[19] *Id.*; *see also* C. Timothy Lindstrom, "A Tax Guide to Conservation Easement Syndications," 47 *Real Est. Rev.* 3 (Winter 2018).

5. Must all partners agree to settle?

The settlement initiative generally is open only to partnerships in which *all* partners agree to the settlement terms. However, the offer letters ambiguously state: "The IRS may consider offers to resolve cases on terms similar to those contained herein where fewer than all partners in the partnership agree to enter into the settlement. In such cases, the IRS may revise certain terms, including, for example, by requiring a greater penalty than the penalty required under the settlement initiative."

6. What happens if some partners are under IRS criminal investigation?

The settlement initiative is not available to any partnership in which one or more partners are under criminal investigation, yet the offer letters also ambiguously state that "the IRS may consider offers from the partners in such a partnership who are not under criminal investigation to resolve the case on terms similar to those contained herein."

7. If the partnership agrees to settle, who determines who owes what?

The partnership must do all this work. The offer letters indicate that the partnership must provide the IRS with computations of the settlement amount (as defined later) within 90 days of the day on which the partnership elects to participate in the settlement initiative. The IRS indicates that it might grant extensions of this 90-day limit on a case-by-case basis, but it "encourages" partnerships and their partners to start crunching numbers immediately.

The offer letters state that partners can submit documentation to support the calculation of their share of the settlement amount, but that this does not relieve the partnership of its duty to provide the IRS with an "aggregated proposed settlement amount and interest."

All computations provided, either by the partnership or its partners, are subject to review and approval by the IRS. Moreover, the IRS warns that if the partnership or any partner submits a computation containing a "material error," the election to participate in the settlement initiative will be void, and the partnership and all partners will be ineligible to participate.

8. If the partnership agrees to settle, who must pay the IRS, and by when?

The partnership must pay the entire settlement amount before or when the partnership and its partners submit their executed Forms 906 to the IRS.

9. Does the IRS treat all partners the same?

No. The offer letters describe two types of partners. Category 1 partners are those who engaged in any of the following activities or who meet any of the following criteria:

- organized or participated, directly or indirectly, in the sale or promotion of *any* SCET or SST;
- received fees for organizing, selling, or promoting *any* SCET or SST;
- received fees for providing an appraisal in *any* SCET or SST;
- received fees for providing legal advice or tax advice for *any* SCET or SST;
- received fees for tax return preparation services (including both signing and non-signing preparers) for *any* SCET or SST;
- was a donee/recipient of a conservation easement or a fee simple property interest in *any* SCET or SST;
- was a material adviser for *any* SCET or SST;
- was a partner in a partnership, or an employee of an entity, that engaged in any of the activities listed above when he participated in the SCET or SST; or
- was related to any of the persons that engaged in any of the activities listed above, as defined in section 267(b).

By default, category 2 partners are those who are not category 1 partners.

10. What is the cost of participating in the settlement initiative generally?

The partnership must pay the settlement amount, which consists of three parts: (1) federal income taxes, which vary depending on which category a partner is in; (2) penalties, which vary depending on which category a partner is in and on whether the partnership and all partners filed timely and proper Forms 8886, "Reportable Transaction Disclosure Statement," with the IRS; and (3) interest charges.

11. What is the cost of participating in the settlement initiative in terms of taxes?

The partnership cannot deduct, under section 170 or any other tax provision, any portion of the charitable deduction that it originally claimed on its Form 1065 for the SCET or SST. Likewise, the partners cannot deduct, under section 170 or any other tax provision, any portion of the charitable deduction that flowed through to the partners.

Under the settlement initiative, the partnership must pay the federal income tax liability for each partner for each year affected by the SCET or SST, calculated as follows: Category 1 partners cannot claim any deduction for contributions of cash or other property to participate in an SCET or SST. In other words, category 1 partners get a charitable deduction of $0 and essentially lose their investment in the partnership.

By contrast, category 2 partners can claim an ordinary tax deduction equal to the out-of-pocket costs paid to participate in the SCET or SST, which includes both cash and other property contributed in exchange for partnership interests. However, there is a caveat: The IRS explains that these deductions are reduced by any previous distributions from the partnership, as well as by any deductions previously claimed by category 2 partners and not disallowed by the IRS.

12. What is the cost of participating in the settlement initiative in terms of penalties?

The partnership must aggregate all penalties for all partners for all affected years in calculating the settlement amount. The penalties fall into two categories: (1) accuracy-related penalties under section 6662, and (2) penalties under section 6707A for failure to file Form 8886.

The settlement initiative contemplates accuracy-related penalties. For category 1 partners, the highest penalty asserted by the IRS in the notice of final partnership administrative adjustment or the highest penalty asserted by the IRS attorney later during Tax Court litigation will apply. Generally, this is the 40 percent penalty for a gross valuation misstatement.

For category 2 partners, the accuracy-related penalty is based on one of three percentages, depending on the return-on-investment ratio. If the partner claimed a charitable deduction that was between one and five times his investment in the partnership that engaged, directly or indirectly, in the SCET or SST, the penalty is 10 percent of the tax underpayment. If the partner claimed a charitable deduction that was between 5.1 times and eight times his investment in the partnership, the penalty is 15 percent of the tax underpayment. And if the partner claimed a charitable deduction that was more than eight times his investment in the partnership, the penalty is 20 percent of the tax underpayment.

The settlement initiative includes further penalties for situations in which the partnership or particular partners failed to file Form 8886. The IRS provides the following guidelines in this regard: (1) the partnership must provide evidence, documents, or affidavits that the partnership and all its partners filed timely and proper Forms 8886; and (2) if any party failed to do so, the settlement amount will include a penalty under section 6707A. For listed transactions, like an SCET or SST, the maximum penalty for individual partners is $100,000, while the maximum for entities is $200,000. The minimum penalty is $5,000 for individuals and $10,000 for entities.

13. What is the cost of participating in the settlement initiative in terms of interest?

The partnership must aggregate all interest required by law for all partners for all affected years (on both the tax liabilities and penalties), and interest suspension under section 6404(g) will not apply.

14. Will participating in the settlement initiative affect tax attributes?

Yes. The offer letters state that all partners, including both category 1 partners and category 2 partners, must adjust any tax attributes (for example, carryovers and basis) to conform to the terms of the settlement initiative.

15. Will participating in the settlement initiative permanently end IRS problems?

No. The offer letters emphasize that participation in the settlement initiative will not affect, limit, or prohibit the IRS in later asserting criminal penalties, promoter penalties, appraiser penalties, return preparer penalties, discipline under Circular 230, or any other penalty. If that were not clear enough, the letters go on to state that nothing in the settlement initiative "precludes the [IRS] from investigating any associated criminal conduct or recommending prosecution of any individual or entity that participated in, or assisted or advised others in participating in, [an SCET or SST] for violation of any criminal statute."

16. Can docketed Tax Court cases now before the Appeals Office participate?

Yes. The offer letters explain that in situations in which a petition involving an SCET or SST was filed with the Tax Court and the case was then automatically routed to the Appeals Office for reconsideration, if the partnership and its partners elect to participate in the settlement initiative, the Appeals Office will return the case to the IRS attorneys for implementation.

17. What must participating partnerships and partners do besides sign and pay?

The partnership and all its partners must agree to "fully cooperate" with the IRS during the settlement process, which includes providing all additional information requested.

18. Will partners be required to disclose personal data to participate?

Yes. The offer letters explain that all partners must execute Form 8821, "Tax Information Authorization," to permit the partnership and the partners to calculate the settlement amount by aggregating the tax liabilities, penalties, and interest charges for each partner for each affected year.

19. Who must sign Forms 906 with the IRS?

The offer letters state that the partnership, as well as "all direct and indirect partners," must execute a Form 906 consistent with the terms of the settlement initiative. It is common in SCETs and SSTs for individual partners to purchase interests in one partnership (InvesCo), which, in turn, makes a capital contribution to the partnership (PropCo) that owns the land and donates the conservation easement and/or fee simple interest to a charitable organization. The offer letters seem to indicate that PropCo, all direct partners in PropCo, and all indirect partners in PropCo through InvesCo will need to execute Forms 906.

20. Can partners change their mind later and seek a refund?

No. The offer letters confirm that the Forms 906 will provide that the settlement amount payment will not be refundable.

21. Can the partnership or partners deduct amounts paid to the IRS?

No. Forms 906 will provide that the settlement amount will not be deductible for federal income tax purposes under any circumstances.

V. Uncertainty and Other Downsides

The IRS's release about the settlement initiative, together with its offer letters to various partnerships, leave many issues unresolved or obscured.

A. No Effect on State Tax Issues

The settlement initiative addresses only federal income tax and related issues (that is, issues with the IRS); it does not cover state income tax issues. In other words, although participation in the settlement initiative might allow the partnership and its partners to rectify federal income tax issues related to an SCET or SST, it would not rectify past issues with any state tax authority. The IRS generally shares information that it gathers about taxpayers with the relevant state tax authorities, including Forms 906. Moreover, many states, like Georgia, have laws requiring taxpayers to file amended state income tax returns within a limited time when changes occur at the federal level.[20] Accordingly, when calculating the true cost of participating in the settlement initiative with the IRS, the partners likely must add the costs (in terms of tax liabilities, penalties, and interest charges for each affected year) of rectifying matters with the relevant state tax authorities.

B. Lack of Unanimity Poses Problems

The IRS first indicates in the offer letters that this is an all-or-nothing proposition: Either every partner in the relevant partnership accepts the

[20] *See* Ga. Code Ann. section 48-7-82(e)(1). This provision requires Georgia taxpayers to file amended state income tax returns within 180 days of any change in net income at the federal level made by the IRS or any other competent U.S. tax authority.

terms, or none of them is eligible. Then, backtracking somewhat, the letters explain that the IRS might consider resolving matters through the settlement initiative in situations lacking unanimity, but that this could trigger higher penalties (than the normal 10 percent, 15 percent, or 20 percent). The IRS provides no details in this regard, but personal experience shows that in cases of partial participation, the IRS raises the standard penalty on category 2 partners by at least 5 percent. Many tax practitioners warned from the outset that a unanimity requirement could be the downfall of the settlement initiative.[21]

Similarly, the IRS proclaims that the settlement initiative is out of reach for partnerships whose partners include at least one under criminal investigation. Changing course, the offer letters explain that the IRS might consider participation in the settlement initiative by only the partners who have no potential criminal exposure. Again, the IRS supplies no specifics.

C. Full Payment Is Unlikely

Concluding matters under the settlement initiative is not cheap under any scenario. Indeed, a partnership must pay the settlement amount, which consists of federal income taxes, penalties, and interest charges. The offer letters demand that the partnership pay the *entire* settlement amount before or when the partnership and all its direct and indirect partners submit their Forms 906 to the IRS. Full payment by all partners seems unrealistic in normal conditions, but it appears particularly questionable now, amid a massive economic slowdown caused by the coronavirus, when many people have lost jobs, savings, retirement accounts, houses, and hope. The IRS gives no hint that it will allow a partnership and its partners to participate in the settlement initiative if some partners must resolve payment matters through an installment agreement or offer in compromise.

D. Key Terms Are Left Undefined

Category 1 partners face unfavorable settlement terms, consisting of charitable deductions of $0, penalties of 40 percent, and interest charges accruing over many years. Logically, taxpayers would like to avoid classification as a category 1 partner. One problem is that in describing the relevant activities and criteria in the offer letters, the IRS did not define, limit, or clarify the pivotal terms for purposes of the settlement initiative. For instance, "organize," "sell," "promote," "participate," "material adviser," "tax return preparation," "signing preparer," "non-signing preparer," and other terms used in the offer letters are technical terms of art, defined differently in various parts of the IRC, the tax regulations, IRS pronouncements, and court decisions.

E. Eligibility of Non-TEFRA Partnerships

Most partnerships that donate conservation easements or fee simple interests in property are subject to the special audit rules introduced in the 1982 Tax Equity and Fiscal Responsibility Act. This is because they have more than 10 partners, or at least one of their partners is a passthrough entity.[22] Under the TEFRA rules, instead of auditing each of the partners separately, the IRS audits the partnership, and any adjustments resulting from the audit (such as a reduction of the charitable contribution deduction) then filter to the partners based on their ownership percentage in the partnership.

Some partnerships that make charitable donations are called "syndicated" because they were promoted to a handful of partners, but they do not qualify as TEFRA partnerships. In these situations, the IRS audits each of the partners individually, not the partnership. The result is that partners in a syndicated non-TEFRA partnership might not be eligible for the settlement initiative because the IRS would not be addressing matters at the partnership level, would not be in a position to send an offer letter to the partnership, and might have little incentive to grant the partners a chance to participate since the IRS must spend its resources to challenge them individually anyway.

[21] Kristen A. Parillo, "Partner Buy-In Rule Could Spoil Some IRS Easement Settlements," *Tax Notes Federal*, June 29, 2020, p. 2338.

[22] Sections 6221 and 6231(a).

In all events, neither the IRS release about the settlement initiative nor the offer letters address the eligibility of syndicated non-TEFRA partnerships.

F. No Finality

Participation in the settlement initiative does not limit or prohibit the IRS from later asserting criminal penalties, promoter penalties, appraiser penalties, return preparer penalties, discipline under Circular 230 with the Office of Professional Responsibility, or any other penalty. This is noteworthy because when taxpayers normally execute a Form 906 with the IRS, all matters covered thereby are considered "final and conclusive" unless there is a later showing of fraud, malfeasance, or material misrepresentation by the taxpayer.[23]

Ponder the following possibility derived from the release and offer letters: An accountant becomes a partner in an SCET, encourages some of his clients to do the same in exchange for a commission or similar fee, writes a tax opinion on which the partnership relies, and prepares the Form 1065 for the partnership. Although he believes in the validity of the transaction and the corresponding easement valuation, the accountant, classified as a category 2 partner, agrees to participate in the settlement initiative for the benefit of the other partners. The accountant signs his Form 906 and pays all amounts due, after accepting a charitable deduction of $0 and a penalty of 40 percent. He hopes that conceding the issues with the IRS and voluntarily paying the highest amount will conclude matters, but he is wrong.

G. Creates Potential Liability

Participation in the settlement initiative requires each partner to sign a Form 906 with the IRS confirming in writing that he is either a category 1 partner or a category 2 partner. If a partner concedes that he falls into the former category, it might be construed as an admission that he did one or more of the following in connection with an SCET or SST: (1) organized, sold, or promoted; (2) prepared an appraisal; (3) provided legal or tax advice; (4) supplied return preparation services; or (5) took actions making him a material adviser. These types of admissions might cause serious problems for a partner with the IRS, particularly if he made prior filings with the IRS that were inconsistent or later becomes the target of a criminal investigation, promoter penalty audit, return preparer penalty audit, etc. Moreover, such admissions by a partner might be exploited by plaintiffs' attorneys, who are busy filing lawsuits nowadays against individuals and firms involved with the planning, structuring, or implementation of partnerships that donated a conservation easement.[24] Finally, the Justice Department — which has already filed one lawsuit seeking an injunction of easement-related activities and disgorgement of proceeds from those activities — would surely find some use for admissions of organizing, selling, promoting, or advising on easement transactions.[25]

H. Time Frame Remains Unclear

Ambiguity regarding the duration of the settlement initiative is also a problem. The IRS stated in its release that this is a "time-limited settlement" and that the IRS, in its sole discretion, will decide which partnerships receive an offer to participate. This creates a conundrum for some partnerships, because only "docketed" cases are eligible.

Take, for instance, a partnership that agreed to extend the assessment period before the IRS announced the settlement initiative, received an examination report or the like, filed a protest letter to elevate the dispute to the Appeals Office, and knows that the relevant deed has a potentially fatal technical flaw. If the partnership were to contact the Appeals Office, retract the protest letter, request the immediate issuance of an FPAA, and then file a petition with the Tax Court to convert the matter into a docketed case, would this somehow ensure receipt of an offer letter from the IRS? What about a partnership that is under audit, decides to waive its right to

[23] Section 7121(b).

[24] *See, e.g.*, Complaint, *Lechter v. Aprio LLP*, No. 1:20-cv-01325 (N.D. Ga. Mar. 26, 2020); and Complaint, *Turk v. Morris, Manning & Martin LLP*, No. 1:20-cv-02815 (N.D. Ga. July 3, 2020).

[25] *See* Complaint, *United States v. Zak*, No. 1:18-cv-05774 (N.D. Ga. Dec. 18, 2018).

reconsideration by the Appeals Office in order to draw a quick FPAA, and then files a petition to become a docketed case? Would this definitely trigger an offer letter?

The IRS has given no assurances. On the contrary, high-ranking IRS officials have publicly stated that the IRS is being "strategic" in deciding which partnerships receive offer letters, excluding some partnerships because their cases contain "unique issues that could further develop the law" and "for other reasons."[26]

I. No Carrot for Category 2 Partners

The hallmark of any settlement is that both sides leave something on the table, and thus nobody walks away fully satisfied. This is certainly true with most voluntary disclosure programs offered by the IRS, such as the offshore voluntary disclosure program, the streamlined foreign offshore procedure, and the streamlined domestic offshore procedure.[27] However, the conservation easement settlement initiative, at least for some partners, seemingly has no upside.

The IRS's standard approach in easement donation cases is to fully disallow the charitable deduction based on one or more of the technical arguments described earlier. In other words, the IRS initially claims that the partnership is entitled to a deduction of $0 because of supposed flaws in the hundreds (if not thousands) of pages prepared in connection with a typical conservation easement. Then, as a backup plan, the IRS claims that the charitable deduction should be $0 because of supposed valuation problems. Further, the IRS typically proposes several alternative penalties against the partnership, ranging in severity. These invariably start with the 40 percent penalty for a gross valuation misstatement. This is consistent with the ATG, which explains that an FPAA "will generally include a tiering of proposed penalties with multiple alternative positions."[28]

Under the settlement initiative, category 1 partners get hit with a charitable deduction of $0 and a 40 percent penalty, plus they must pay the entire amount right away. Thus, if category 1 partners participate in the settlement initiative, they are guaranteeing themselves the worst possible outcome, consistent with most FPAAs. They are also making various admissions, as explained earlier, that might prejudice them in other contexts.

However, if they decline the settlement initiative, and the partnership proceeds to Tax Court litigation, there remains a possibility of getting some amount of charitable deduction and lower or no penalties. This reticence to settle, though, might put category 1 partners at odds with category 2 partners, who might be eager to participate in the settlement initiative, accept a charitable deduction equal to the amount they invested, pay the reduced penalty, avoid a capital call for litigation fees, and chalk it up to a lesson learned. A cynic might conclude that this is exactly what the IRS wanted from the outset, placing category 1 partners and category 2 partners in conflict — the classic divide-and-conquer strategy.

VI. Conclusion

Given the bottleneck of conservation easement cases in the Appeals Office and Tax Court, the huge volume of future disputes resulting from widespread auditing, the finite resources of the IRS, and recent victories in the Tax Court based solely on technical issues, introduction of the settlement initiative is logical from the IRS's point of view. The bigger question is, once partners focus on the key issues, will participation in the settlement initiative be logical from theirs? ■

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[26] Parillo, "Criticism of Easement Settlement Deal Doesn't Worry IRS," *Tax Notes Federal*, July 20, 2020, p. 534.

[27] Hale E. Sheppard, "IRS Amnesty Covers More Than Foreign Accounts: Analyzing the Updated Voluntary Disclosure Practice, New International Tax Withholding Procedure, and Guidelines for Late Returns by Foreign Corporations," 97 *Taxes* 19 (2019).

[28] ATG, *supra* note 5, at 82.